



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201129049**

Release Date: 7/22/2011

Date: April 26, 2011

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Contact Person:

XXXXXX

Identification Number:

XXXXXX

Telephone Number:

XXXXXX

Employer Identification Number:

XXXXXX

Uniform Issue List:

4941.04-00

Legend:

A = XXXXXX

B = XXXXXX

C = XXXXXX

M = XXXXXX

O = XXXXXX

X = XXXXXX

Date 1 = XXXXXX

Date 3 = XXXXXX

Dear

This is in reply to your letter of July 26, 2010, concerning the federal income and excise tax consequences under section 4941 of the Internal Revenue Code (Code) relating to the administration of an estate, in the manner and for the purposes described below.

Facts

A is a privately held corporation that files its annual tax return on Form 1120, U.S. Corporation Income Tax Return. B is the founder of A and X. B is a substantial contributor, as defined in section 507(d)(2)(A) of the Code, to X. B is also the grantor of M. C is married to B, and is the grantor of O. On Date 1, B founded and funded X to further religious and educational organizations. X is exempt from federal income tax under section 501(c)(3) of the Code and is a private foundation within the meaning of section 509(a) of the Code. X is the primary beneficiary of the estates of both B and C. Upon their deaths, X will receive, by way of bequest, cash and notes received from the redemption of A non-voting shares held by M and O.

B's will leaves all of the assets owned by him at his death to M. Upon his death, M will become irrevocable, and it is anticipated that the executor and trustee will elect, under section 645 of the

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Code, to have M taxed as a part of B's estate. X is a beneficiary of M, and pursuant to M's terms, X is to receive all A non-voting shares owned by M at B's death.

When C dies, her will bequeaths her residuary estate to O, and O then transfers all of the A non-voting shares owned by it at C's death to X.

During the administration of B's estate and pursuant to the terms of an A shareholders' agreement, it is expected that when B dies, A will elect to exercise its option under the shareholders' agreement to purchase the A non-voting shares owned by M. Similarly, it is expected that upon C's death, A will elect to exercise its option to purchase the A non-voting shares owned by O. In each case, the A non-voting shares will be purchased in accordance with the terms of an A shareholders' agreement for cash and/or an A promissory note. If A elects to issue one or more promissory notes to purchase the A non-voting shares, each promissory note will provide interest paid at not less than the applicable federal rate, will have a term of no longer than 25 years, and will have a fair value of not less than the note's face value.

After the deaths of B and C, A's purchase of the A non-voting shares from M and O will be submitted for approval to a probate court or another court having proper jurisdiction over the estate. M and O will transfer any cash and A promissory notes that they receive from the sale of their A non-voting shares to X. A will remain obligated and continue to make interest and principal payments to X until the A promissory notes are satisfied in full.

Ruling Requested

You have requested that X's holding of an A promissory note and its receipt of A promissory note payments from A after the period of estate administration terminations will meet all of the requirements of section 53.4941(d)-1(b)(3) of the Foundation Regulations, and therefore, will not be deemed acts of self-dealing subject to excise tax under section 4941(a) of the Code.

Law

Section 501(c)(3) of the Code provides, in part, for the exemption from federal income tax of corporations organized and operated exclusively for charitable, scientific, or educational purposes, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 507(d)(2)(A) defines a substantial contributor as any person who contributed or bequeathed an aggregated amount of more than \$5,000 to a private foundation, if such amount is more than 2 percent of the total contributions and bequests received by the foundation before the close of the taxable year of the foundation in which the contribution or bequest is received by the foundation from such person. In the case of a trust, the term substantial contributor also means the creator of the trust.

Section 509(a) provides that, unless specifically excepted, a domestic or foreign organization described in section 501(c)(3) is a private foundation and subject to the excise taxes of chapter 42 of the Code.

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Section 4941(a) of the Code imposes an excise tax on acts of self-dealing between a private foundation and any of its disqualified persons as defined in section 4946.

Section 4941(d) of the Code defines self-dealing as including (1) the sale or exchange of property and (2) the lending of money or other extension of credit between a private foundation and a disqualified person whether done directly or indirectly.

Section 4946(a)(1) provides, in part, that the term "disqualified person" means, with respect to a private foundation, a person who is –

- (A) a substantial contributor to the foundation,...
- (D) a member of the family...of any individual described in subparagraph (A)...
- (E) a corporation of which persons described in subparagraph (A)...or (D) own more than 35 percent of the total combined voting power...
- (G) a trust or estate in which persons described in subparagraph (A)...or (D) hold more than 35 percent of the beneficial interest,...

Section 53.4941(d)-1(b)(3) of the Foundation Regulations (foundation regulations) relating to transactions during the administration of an estate or revocable trust, provides that the term indirect self-dealing shall not include a transaction with respect to a private foundation's interest or expectancy in property (whether or not encumbered) held by an estate (or revocable trust, including a trust which has become irrevocable on a grantor's death), regardless of when title to the property vests under local law, if –

- (i) The administrator or executor of an estate or trustee of a revocable trust either –
 - (a) Possess a power of sale with respect to the property,
 - (b) Has the power to reallocate the property to another beneficiary, or
 - (c) Is required to sell the property under the terms of any option subject to which the property was acquired by the estate (or revocable trust);
- (ii) Such transaction is approved by the probate court having jurisdiction over the estate (or by another court having jurisdiction over the estate (or trust) or over the private foundation;
- (iii) Such transaction occurs before the estate is considered terminated for federal income tax purposes pursuant to paragraph (a) of section 1.641(b)-3 of the regulations (or in the case of a revocable trust, before it is considered subject to section 4947);

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- (iv) The estate (or trust) receives an amount which equals or exceeds the fair market value of the foundation's interest or expectancy in such property at the time of the transaction taking into account the terms of any option subject to which the property was acquired by the estate (or trust); and
- (v) With respect to transactions occurring after April 16, 1973, the transaction either –
 - (a) Results in the foundation receiving an interest or expectancy at least as liquid as the one it gave up,
 - (b) Results in the foundation receiving an asset related to the active carrying out of its exempt purposes, or
 - (c) Is required under the terms of any option which is binding on the estate (or trust).

Section 53.4941(d)-2(c)(1) of the foundation regulations provides, in part, that except in the case of the receipt and holding of a note pursuant to a transaction described in section 4941(d)-1(b)(3) of the foundation regulations, an act of self-dealing occurs when a note, the obligor of which is a disqualified person, is transferred by a third party to a private foundation which becomes the creditor under the note.

Analysis

Generally, transactions between a disqualified person and a foundation are subject to the self-dealing rules set forth in section 4941 of the Code. Section 4941(d)(1)(a) defines "self-dealing" to include "any direct or indirect . . . sale or exchange, or leasing, of property between a private foundation and a disqualified person." Under section 53.4941(d)-1(b) of the regulations, the sale by an estate of property in which a private foundation has an expectancy under a will can be an act of indirect self-dealing. If the transaction described above were determined to be an act of self-dealing, it would subject the self-dealing persons to an excise tax on "each act of self-dealing between a disqualified person and a private foundation" pursuant to section 4941(a)(1). However, in order to apply section 4941 we must first determine if there are disqualified persons in the transaction with the private foundation.

Here, B is a disqualified person with respect to X under section 4946(a)(1)(E) of the Code as a substantial contributor to X. Section 507(d)(2)(A) of the Code defines a substantial contributor as any person who contributed an aggregate amount of more than \$5,000 to a private foundation, if such amount is more than 2 percent of total contributions. B has contributed substantially more than \$5,000 which you state was more than 2% of total contributions. Additionally, C is a disqualified person with respect to X pursuant to section 4946(d) of the Code. That section states that "a member" of the family of a disqualified person includes the spouse, children of and grandchildren of a disqualified person. C is the spouse of a disqualified person. Thus, C is a disqualified person with respect to X.

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However, transactions during the administration of an estate regarding the foundation's interest or expectancy in property held by such estate are not self-dealing if all five conditions set forth in section 53.4941(d)-1(b)(3) of the regulations are met. Such exception to the self-dealing rules is commonly referred to as the "estate administration exception." Section 53.4941(d)-1(a) of the foundation regulations states that the term "self-dealing" means any direct or indirect transaction described in section 53.4941(d)-2. Section 53.4941(d)-2(c) provides that the lending of money and other extension of credit between a private foundation and a disqualified person shall constitute an act of self-dealing. For example, an act of self-dealing occurs where a note, the obligor of which is a disqualified person, is transferred by a third party to a private foundation which becomes the creditor under the note. However, section 53.4941(d)-2(c) also provides that such a transfer of a note to a private foundation does not constitute self-dealing if the foundation receives and holds the note pursuant to a transaction described in section 53.4941(d)-1(b)(3).

X is the primary beneficiary of the estates of both B and C. Upon their deaths, X will receive (by way of bequest) cash and notes received from the redemption of A non-voting shares held by M and Q. A is a disqualified person under section 4946(a)(1) with regard to X because B owns more than 35% of the total combined voting power of A, and he is a substantial contributor with respect to X.

Where a note has been issued subject to all the safeguards enumerated in section 53.4941(d)-1(b)(3), receipt and continued holding of the promissory note will not be deemed an extension of credit between a foundation and a disqualified person for purposes of section 4941. Therefore, X's holding of an A promissory note and its receipt of A promissory note payments from A after the period of estate administration termination will meet the requirements of section 53.4941(d)-1(b)(3) because:

- (i) The trustees of M and Q are required to sell the A non-voting shares under the terms of the shareholder agreement with A. When B dies, A will elect to exercise its option to purchase the A non-voting shares from M, and when C dies, A will elect to exercise its option to purchase the A non-voting shares from Q;
- (ii) After the deaths of B and C, the transfers will be approved by the probate court or other court having proper jurisdiction over each estate;
- (iii) M and Q will transfer any cash and A promissory notes that they receive from the sale of their A non-voting shares to X;
- (iv) The exercise of A's option to purchase the A non-voting shares from M and Q is binding on M and Q.

Ruling

X's holding of an A promissory note and its receipt of A promissory note payments from A after the period of estate administration terminations will meet the requirements of section

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53.4941(d)-1(b)(3) of the Foundation Regulations, and therefore, will not be deemed acts of self-dealing subject to excise tax under section 4941(a) of the Code.

This private letter ruling request was submitted prior to the issuance of Revenue Procedure 2011-4, Section 6, in which a no-rule position was announced with regard to self-dealing issues involving the issuance of a promissory note by a disqualified person during the administration of an estate or trust.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Steven Grodnitzky
Manager, Exempt Organizations
Technical Group 1

Enclosure
Notice 437